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CREDIT OPINION
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New Issue

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State of Hawaii

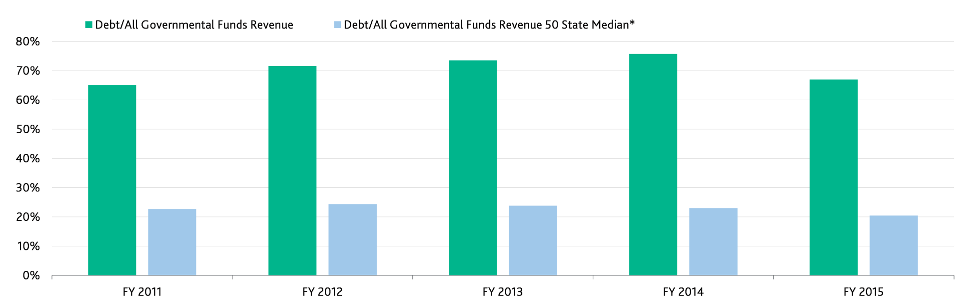
New Issue - Moody's upgrades Hawaii's GO bonds to Aa1 from Aa2; outlook stable

Summary Rating Rationale

Moody's Investors Service has raised the rating on the State of Hawaii's general obligation bonds to Aa1 from Aa2 and the rating on its Certificates of Participation (State Office Buildings) 2009 Series A to Aa2 from Aa3. We have also assigned Aa1 ratings to the state's current offering of general obligation bonds to be issued in an estimated total amount of $757 million in four series: Series FG, Refunding Series FH, Refunding Series FI, and Taxable Series FJ. Following this sale, the state will have approximately $6.4 billion general obligation bonds outstanding. The outlook on these ratings is stable.

The upgrade reflects the state's positive economic and revenue trends, the restoration and maintenance of sizable reserves, and proactive measures to improve the funding of its pension and OPEB liabilities. State statutes require it to ramp up its OPEB contribution to 100% of the actuarially required contribution (ARC) by fiscal 2019, but the state contributed more than the statutorily-required amount in fiscal years fiscal years 2014 through 2017, and is likely to meet or exceed the ARC in fiscal 2018. Despite these measures, the state's fixed costs will remain among the highest in the country at least over the medium term. Debt levels are notably above average due to the state's responsibility for financing K-12 capital needs. Hawaii has strong governance practices such as multi-year financial planning, quarterly binding consensus revenue forecasting, and timely financial reporting.

Exhibit 1
Hawaii's Debt Levels Exceed 50-State Medians



Source: Moody's Investors Service US state debt medians reports.

Credit Strengths

- Strong financial governance practices including multi-year planning, quarterly consensus revenue forecasting, and strong executive power to reduce spending.
- Historical fiscal conservatism; prompt action to address revenue shortfalls.
- Low unemployment rates; healthy growth in tourism industry; stable military presence.
- Strong liquidity position.
- Rapid amortization of debt; no exposure to variable rate debt or derivative products.
- Commitment to and progress toward reducing pension and OPEB liabilities, including plans to fund fully the OPEB ARC.

Credit Challenges

- Vulnerability to shifts in Hawaii's tourism-based economy, resulting in revenue falloff and budget shortfalls.
- Large state and local government employment sector that contributes to spending pressure for salary and benefit settlements.
- Debt ratios that are among the highest in the nation, although these debt levels are largely attributable to the state's responsibility for funding all the capital needs of its centralized K-12 school system.
- High pension and OPEB liabilities.

Rating Outlook

The stable outlook reflects the expectation that the state will maintain strong reserves while continuing to make planned progress in funding its pension and OPEB liabilities.

Factors that Could Lead to an Upgrade

- Increased economic diversification and reduced economic volatility.
- Sustained reduction in debt ratios and significant improvement in pension funded ratios, sooner than currently projected.

Factors that Could Lead to a Downgrade

- Economic weakening leading to deteriorating revenue trends, budget imbalance, liquidity pressures, and narrowing of financial position.
- Return to reliance on non-recurring solutions to balance the budget.
- Increased debt ratios relative to other states, or deterioration of pension funded ratios.

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on www.moodys.com for the most updated credit rating action information and rating history.

Key Indicators

Exhibit 2

Hawaii Has Rebuilt Reserves Since the Recession

Hawaii	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015
Operating Fund Revenues (000s)	5,086,023	5,340,250	5,838,577	5,606,221	6,109,019
Balances as % of Operating Fund Revenues	7.0%	11.1%	20.2%	19.2%	25.6%
Net Tax-Supported Debt (000s)	5,360,242	5,912,089	6,636,905	6,908,297	6,523,739
Net Tax-Supported Debt/Personal Income	9.6%	10.0%	10.6%	10.8%	9.9%
Net Tax-Supported Debt/Personal Income 50 State Median	2.8%	2.8%	2.6%	2.5%	2.5%
Debt/All Governmental Funds Revenue	65.1%	71.5%	73.5%	75.7%	67.0%
Debt/All Governmental Funds Revenue 50 State Median*	22.7%	24.3%	23.8%	23.0%	20.4%
Adjusted Net Pension Liability/All Govt Funds Revenue	132.5%	199.1%	125.8%	141.1%	N/A
Adjusted Net Pension Liability/All Govt Funds Revenue 50 State Median	48.7%	63.9%	60.3%	59.2%	N/A
Total Non-Farm Employment Change (CY)	1.3%	2.0%	2.1%	1.1%	1.5%
Per Capita Income as a % of US (CY)	101.1%	100.5%	99.7%	100.0%	100.2%

Source: State audited financial statements with Moody's Investors Service adjustments; Moody's Investors Service state debt and pension medians reports; US Bureau of Labor Statistics; US Bureau of Economic Analysis.

Recent Developments

Recent developments are included in the Detailed Rating Considerations below.

Detailed Rating Considerations

Economy and Tax Base

Although Hawaii's economy has shown some diversification, its large tourism industry remains key to the economy and the state's economic performance closely tracks tourism trends. As a highly desirable tourist destination for international and domestic visitors, the tourism industry is somewhat insulated from US economic cycles and has at times been counter-cyclical. The recent recession was particularly challenging since both national and international visitations were affected at the same time. Visitor arrivals did not surpass the pre-recession peak (2007) until 2012. Growth since that time has been particularly strong, however, and visitor arrivals reached record levels in 2015 (8.6 million) and are projected to hit a new record in 2016 (8.8 million). Hotel revenues per room night are also expected to reach $202 in 2016, compared to $124 in 2010.

A sizable military presence adds stability, and military housing construction has contributed to expanding construction activity. Federal defense spending in Hawaii, dictated by the island's strategic geographic importance, plays a large part in the state's economy. Federal activity amounts to about 12% of Hawaii's gross state product, with much of it defense related.

The economy is also boosted by strong construction activity. The value of building permits issued has returned to pre-recession levels. Major projects include high-rise condos in Central Honolulu targeted at both visitors and residents, as well as retail commercial projects in Honolulu and new hotel/resort projects primarily on the neighbor islands. Two new master planned communities with a total of 15,250 housing units have been approved in Honolulu and are expected to begin construction in late 2016/early 2017. Large public projects include the Honolulu rail system and improvements at the airports and port.

The state's employment trends are generally less volatile than in other tourism dependent states such as Florida (Aa1 stable) and Nevada (Aa2 stable). Unlike most mainland states, Hawaii did not experience a severe housing market bust during the recession. Hawaii's unemployment rate, 3.3% in for the first half of 2016, remains well below the national average as it was throughout the recession. Median family incomes are among the highest in the nation, but per capita income levels are closer to the US average.

Financial Operations and Reserves

General Fund tax revenue growth was particularly strong in fiscal 2013, 10.0% on a budget basis and 8.2% on a GAAP basis. This growth reflected a continuation of the underlying economic strength that produced strong growth in 2010, 2011, and 2012. But it also reflected some one-time factors including the acceleration by taxpayers of capital gains income into calendar 2012 due to federal tax law changes and delays in processing certain payments related to tax collection makeup for the City and County of Honolulu (Aa1 stable) in late fiscal 2013.

Growth in tax revenues stalled in fiscal 2014. Total tax revenues dropped 1.8% from 2013 on a budget basis and 4.0% on a GAAP basis. This decline reflected, in part, the one-time factors in fiscal 2013. Additionally, a $55.5 million deposit in the Hawaii Hurricane Relief Fund (HHRF) was excluded from General Fund revenues. Nevertheless, recurring tax revenues remained essentially flat. Officials estimate that after adjusting for the makeup payments to Honolulu and the HHRF deposit, total tax revenues on a declined by 0.2% on a budget basis.

Driven by the underlying economic trends, strong growth resumed in fiscal 2015. General Fund tax revenues increased by an estimated 6.8% over 2014 levels on a budget basis and 9.0% on a GAAP basis. Preliminary actual results for fiscal 2016 show that General Fund tax revenues increased by slightly over 8% on a budget basis.

In its September 2016 forecast, the Hawaii Council of Revenues projects that General Fund tax revenues to increase by 5.5% in fiscal 2017, an increase from its previous 5.0% projection. The council is currently projecting revenue growth of 4.4% to 5.0% per year in the out years (2018-2021) of its multi-year forecast period.

Strong reserve levels are important for Hawaii given the state's vulnerability to national and international shifts in its essential tourism-based economy. Balance sheet deterioration during the recent recession reflected the state's use of one-time actions for budget relief, including the use of reserve balances from both the Emergency and Budget Reserve Fund (EBRF) and the HHRF. At the low point, the state reported negative GAAP balances for fiscal years 2009 and 2010. In the prior 2001 recession, the state's available reserves hit a low of about 7.5% operating revenues at the end of fiscal 2003, but were never negative.

As its economy has recovered, Hawaii has rebuilt its balances to a healthy position relatively quickly. Moody's measure of available GAAP-basis reserves (primarily unassigned General Fund balance plus the HHRF) grew to a strong 20.2% of operating revenues at the end of fiscal 2013, up from 11.1% at the end of fiscal 2012 and essentially equal to the pre-recession peak of 21% at the end of fiscal 2006. Reserves remained essentially unchanged in fiscal 2014 due to the flat revenues in that year and because the state increased its OPEB contribution to $100 million greater than required by statute. Available reserves increased again in fiscal 2015, reaching a record 25.6% of revenues.

On a budget basis, total reserves, including the General Fund ending balance plus the EBRF but excluding the HHRF, are estimated to have increased by $210 million in 2016 to $1.13 billion or 15.9% of revenues. Current projections show reserves being drawn down in slightly in 2017 due to one-time spending for capital projects and a budgeted supplemental OPEB contribution of $97.6 million. Reserves are expected to increase again in 2018, but projections do not include allowances for salary increases. Collective bargaining agreements expire at the end of fiscal 2017.

LIQUIDITY

Hawaii does not engage in short-term borrowing for cash flow purposes and relies on pooled treasury cash for temporary internal borrowing as needed. During the recession, when the state's General Fund reserves were depleted, some liquidity strain was indicated by payment deferrals at the end of fiscal 2009 and the delay of fiscal 2010 personal income tax refunds until fiscal 2011. But liquidity levels have improved substantially since that time and the state has not engaged in any additional deferrals.

Debt and Pensions

DEBT STRUCTURE

Hawaii compares unfavorably with other states on measures such as debt ratios, pension funding levels, and OPEB liabilities. Debt per capita is $4,557 ranking Hawaii third highest among the states and over four times Moody's 50-state median of $1,025. As a percentage of personal income, Hawaii's debt is the highest in the country at 9.9%, compared with the median of 2.5%.

These debt ratios are, in part, attributable to the fact that, unlike other states Hawaii, is entirely responsible for the capital needs of its centralized K-12 school system. Total state and local government debt ratios indicate that the state’s debt is a more manageable burden on the state’s economy than suggested by comparison to the state medians. Nevertheless, the state’s high levels of direct debt, along with its large pension liability and aggressive OPEB funding plan, contribute to its high fixed costs.

Hawaii’s general obligation bonds are conservatively structured with a maximum maturity of 20 years and level annual debt service. As a result, payout of the state's general obligation debt is relatively rapid. Prior to the current offering, 67% of principal is repaid in 10 years.

DEBT-RELATED DERIVATIVES

The state has no variable rate debt and no debt-related derivatives.

PENSIONS AND OPEB

The state's pension liabilities are above average. Moody's 2014 Adjusted Net Pension Liability (ANPL) for Hawaii was 141% of state governmental revenues, the seventh highest of the 50 states and more than twice times the median of 59%. Hawaii's three-year average ANPL was 149% of revenues, the fifth highest and well above the median of 53%.

Pension reforms adopted in 2011 are expected to improve the funding levels of the state's retirement system over the long term. Benefits were reduced for new members after June 30, 2012, and employer contributions were increased to 17% of payroll. A moratorium on any enhancement of retirement benefits remains in effect until the funded ratio reaches 100%. Additional reforms approved by the legislature and the governor in 2012 focused on reducing the "spiking" of final compensation. These later changes have the largest potential impact on counties who employ most of the police and fire workers. The state currently projects that the unfunded liability will be fully amortized in 26 years.

Hawaii's OPEB unfunded obligation is also quite sizeable. The valuation report for July 1, 2015 showed an total unfunded obligation of $11.8 billion, of which approximately $9.1 billion was the state's portion.

As in most states, Hawaii historically funded its OPEB costs on a pay-go basis. However, in the 2013 legislative session, the state adopted a plan to require phasing in higher annual contributions by the state and counties beginning in fiscal 2015. By fiscal 2019, the payments would reach 100% of the ARC. Notably, the state also made a supplemental contributions to the OPEB trust beyond the statutorily-required amounts--$100 million in fiscal 2014, $34 million in 2015, $86 million in 2016, and $98 million (budgeted) in 2017.

Management and Governance

Hawaii has very strong governance practices, including consensus revenue forecasts, updated quarterly, and multi-year financial planning. The governor has power to restrict spending during the fiscal year, if necessary. The constitution does not provide for voter initiatives. The state plans to adopt a debt affordability study and debt polices in fiscal year 2017.

Legal Security

The four series of bonds that comprise the current offering are general obligations of the state, to which the state has pledged its full faith, credit and resources. The bonds have a first charge on all general fund resources.

Use of Proceeds

Proceeds of the Series FG and Taxable Series FJ bonds will fund various state public improvement projects. Proceeds of the Series FH and FI bonds will be used to refund outstanding bonds for debt service savings.

Obligor Profile

Hawaii is the 40th largest state by population, at 1.4 million. Its state gross domestic product is 38th largest. The population's income levels are above average, with per capita personal income equal to 100% of the US level and a median household income equal to 133%. Its poverty rate is in the bottom third among states.

Methodology

The principal methodology used in this rating was US States Rating Methodology published in April 2013. Please see the Ratings Methodologies page on www.moodys.com for a copy of this methodology.

Ratings

Exhibit 3

Hawaii (State of)

Issue	Rating
General Obligation Refunding Bonds of 2016, Series FH	Aa1
Rating Type	Underlying LT
Sale Amount	$353,465,000
Expected Sale Date	09/26/2016
Rating Description	General Obligation
General Obligation Refunding Bonds of 2016, Series FI	Aa1
Rating Type	Underlying LT
Sale Amount	$3,925,000
Expected Sale Date	09/26/2016
Rating Description	General Obligation
Taxable General Obligation Bonds of 2016, Series FJ	Aa1
Rating Type	Underlying LT
Sale Amount	$25,000,000
Expected Sale Date	09/26/2016
Rating Description	General Obligation
General Obligation Bonds of 2016, Series FG	Aa1
Rating Type	Underlying LT
Sale Amount	$375,000,000
Expected Sale Date	09/26/2016
Rating Description	General Obligation

Source: Moody's Investors Service

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